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In the Supreme Court of the United States

OCTOBER TERM, 1946

No. 852

GORDON M. MATHER, PETITIONER

v.

COMMISSIONER OF INTERNAL REVENUE

**ON PETITION FOR A WRIT OF CERTIORARI TO THE UNITED
STATES CIRCUIT COURT OF APPEALS FOR SIXTH
CIRCUIT**

BRIEF FOR THE RESPONDENT IN OPPOSITION

OPINIONS BELOW

The opinion of the Tax Court (R. 15-23) is reported at 5 T. C. 1001. The *per curiam* order of the court below (R. 51) is reported at 157 F. 2d 680.

JURISDICTION

The judgment of the Circuit Court of Appeals was entered on October 17, 1946. (R. 51.) The petition for a writ of certiorari was filed on January 6, 1947. The jurisdiction of this Court is invoked under Section 240 (a) of the Judicial

Code, as amended by the Act of February 13, 1925.

QUESTION PRESENTED

Whether, under Section 22 (a), Section 166, or Section 167 of the Internal Revenue Code, the taxpayer was taxable on the income of four trusts he had created, each for the benefit of one of his minor children, the taxpayer under each trust having retained the right to elect at any time to have all of the income used for the maintenance and education of the children and to direct the trustee to make investments, and the trustee being required to make all loans, sales, and purchases directed by the taxpayer.

STATUTES INVOLVED

The pertinent statutory provisions are set forth in the Appendix, *infra*, pp. 13-16.

STATEMENT

This is a proceeding involving income tax deficiencies for the years 1940 and 1941 determined by the Commissioner (R. 8-13) against the petitioner (hereinafter referred to as the taxpayer) in the amounts of \$36,939.12 and \$28,237.24, respectively. After two other minor issues were eliminated (R. 41), there was left for decision by the Tax Court only the issue whether the taxpayer was taxable during the years in question on the income of four trusts he had previously

established for the benefit of four of his infant children (R. 15-16). The facts relevant to that issue, as contained in a stipulation (R. 27-30) and an exhibit attached thereto (R. 30-40), and as found by the Tax Court (R. 16-20), may be summarized as follows:

Prior to the taxable years, the taxpayer had created four separate trusts, one each for the benefit of his four minor children, with a corporate trustee.¹ The trustee was given broad administrative powers, including the power to invest and reinvest, either in legal trust investments under the laws of Ohio or "in such securities as the Donor may direct in writing". (R. 16.)

Under Section 6 of Article I of the trust (R. 33-36), after providing that the trustee should pay its compensation and carrying charges out of current income, it was provided that (R. 17):

After making the payments set forth in the second paragraph of this section, or making provision therefor out of said income, the Trustee shall,—subject to the clause hereinafter inserted providing for the use of same for the maintenance and education of said beneficiary, should same become burdensome to Donor,—reinvest the balance of said income from time to time for the benefit of the beneficiary of

¹ The trust instruments were identical, except as to dates, property conveyed, and names of beneficiaries. (R. 16.) A copy of one of the instruments was attached as Exhibit "A" (R. 30-40) to the stipulation of facts.

the Trust Property hereunder until the beneficiary reaches the age of twenty-five (25) years, after which time the Trustee shall pay to said beneficiary the net income from the Trust Property, said payments to be made quarterly or oftener. * * *

Then follow provisions for the distribution of the principal to the beneficiary at the ages of 30, 35 and 40, and provisions for the final disposition of the trust property in the event of the beneficiary's death before the termination of the trust. Then, in Section 6 of Article I, it is further provided that (R, 17):

The Donor retains the right to elect at any time to have all or any part of the net income used for the maintenance and education of his said son, Rathbun Fuller Mather, or said son's lineal heirs.

In Section 4 of Article V of the instrument, it was further provided that (R. 18):

The Trustee is authorized and directed to make all loans, sales and purchases which Donor may hereafter direct in writing.

The Tax Court found, as stipulated, that the trustee had from time to time purchased additional securities, sometimes acting under written directions of the taxpayer; that no loans have ever been made by the trustee as provided for in Section 4 or Article V, and that none of the trust properties have ever been reconveyed to the

taxpayer; that no occasion has arisen when the maintenance and education of the beneficiaries has become financially burdensome to the taxpayer; and that during the taxable years the maintenance and education of the beneficiaries were provided for by the taxpayer from his own funds at a cost of \$10,147.21 in 1940 and \$7,670.20 in 1941. (R. 18-19).

The taxpayer did not include any of the income of the four trusts in his income tax return for 1940, while in his return for the year 1941 he included income from the trusts to the extent of \$7,670.20. Later, after an examination of his return for 1940, the taxpayer consented to the inclusion in his gross income for 1940 of income of the trusts to the extent of \$10,147.21, and paid an additional tax with respect thereto in 1941. (R. 19.)²

Subsequently, the Commissioner determined deficiencies in income tax against the taxpayer for the two taxable years as the result of (in addition to other items not here material) the inclusion in the taxpayer's gross income of all of the income³

² The amounts of \$10,147.21 and \$7,670.20 are equal to the amounts expended by the taxpayer for the maintenance and education of the beneficiaries during the years 1940 and 1941, as already brought out.

³ With respect to one of the trusts, designated as the Mather Trust #36, the income which the Commissioner added to the taxpayer's income for 1941 was the income of that trust only to January 15, 1941, the date the beneficiary became 21 years of age. (R. 28.)

of the four trusts, on the theory that the taxpayer was taxable thereon under Sections 22 (a) and 167 of the Code. (R. 8-13, 19.) In his appeal to the Tax Court, the taxpayer claimed that no part of the income of the trusts was taxable to him and that, instead of the deficiencies, his income tax for 1940 and 1941 had been overassessed in the amounts of \$5,898.25 and \$5,409.79, respectively. (R. 3-7.) Before the Tax Court, the Commissioner contended that the taxpayer was taxable upon the income of the four trusts under Sections 22 (a), 166 and 167 (a) of the Code. (R. 20.)

The Tax Court in its opinion approved the Commissioner's determination that the taxpayer was taxable upon all the income of the trusts (R. 20-23), and accordingly entered its decision sustaining the deficiencies (R. 24).⁴ The court below affirmed the decision of the Tax Court by a *per curiam* order. (R. 51.)

ARGUMENT

The court below correctly upheld the decision of the Tax Court which sustained the Commissioner's determination that the income of these trusts was taxable to the grantor. Before

⁴ The deficiency for 1941 was reduced from \$28,237.24, as originally determined by the Commissioner (R. 13), to \$27,719.74 by the Tax Court (R. 24), as the result of adjustments made with respect to the two minor issues eliminated from the case before the Tax Court, as already pointed out, upon concession by the Commissioner (R. 15-16, 41).

the Tax Court, taxability under Sections 22 (a), 166 and 167 (a) of the Code (Appendix, *infra*) was claimed by the Commissioner. (R. 20.) While the Tax Court did not pass upon the applicability of Section 22 (a), its opinion clearly shows that the Tax Court held the income to be taxable to the taxpayer under Section 167, and that, even if Section 167 were not applicable, the income would nevertheless be taxable to the taxpayer under Section 166. (R. 20-23.) Since the court below "affirmed upon the grounds and for the reasons stated" (R. 51) by the Tax Court in its opinion, the decision below must be regarded as having approved the taxability of the trust income to the taxpayer under Section 167, as well as under Section 166, and not merely under Section 166 alone, as the taxpayer contends (Pet. 1-2, 4-6).

1. In upholding the Commissioner's taxing of the trust income to the taxpayer, the Tax Court concluded that, because of the power reserved by the taxpayer to have all of the income of the trusts applied to the maintenance and education of his minor children-beneficiaries,⁵ the income of

⁵ With respect to that power, reserved (in the eighth paragraph of Section 6 of Article I (R. 35)) as the Tax Court pointed out (R. 21) "in clear and concise words", the Tax Court properly concluded that it was not subject to the alleged condition contained in a parenthetical clause (in the fourth paragraph of Section 6 of Article I (R. 34)) to the effect that the maintenance and education of the children must become burdensome to the taxpayer (R. 20).

the trust was taxable to the taxpayer under Section 167 (a) and the doctrine of *Helvering v. Stuart*, 317 U. S. 154. The Tax Court further concluded that the taxpayer was not relieved from taxation upon the entire trust income by Section 167 (c) of the Code, as amended by Section 134 of the Revenue Act of 1943, c. 63, 58 Stat. 21 (Appendix, *infra*). Where the discretion to apply the trust income to the maintenance and education of a beneficiary whom the grantor is legally obligated to support rests solely in the grantor, Section 167 (c) does not relieve the grantor from taxation under Section 167 (a), unless the grantor has such discretion as a trustee or a cotrustee. See H. Rep. No. 871, 78th Cong., 1st Sess., pp. 32-33 (1944 Cum. Bull. 901); S. Rep. No. 627, 78th Cong., 1st Sess., pp. 28-29, 67-70 (1944 Cum. Bull. 973); H. Conference Rep. No. 1079, 78th Cong., 2d Sess., pp. 58-59 (1944 Cum. Bull. 1059). See also Treasury Regulations 103, Section 19.167-2, as added by T. D. 5392, 1944 Cum. Bull. 328.

The conclusions of the Tax Court in this respect were unquestionably correct under the applicable statutory provisions as interpreted by this Court. Since the decision below is correct on this ground, we believe there is no warrant for review by this Court upon the basis of doubts or conflicts alleged to exist with respect to any alternative ground upon which the decision below was also founded.

2. As noted, the Tax Court also sustained the taxability of the trust income to the grantor under Section 166 of the Code, because of the taxpayer's retention of the right to require the trustee to make such loans, sales and purchases as he (the taxpayer) might direct in writing. (R. 22-23.) As the Tax Court pointed out (R. 22), the taxpayer was not under any fiduciary obligation to use his retained rights for the benefit of the beneficiaries, and he could have required the trustee to lend or sell the trust assets to him upon any terms he might have named. The retention of such rights has been consistently held, as the Tax Court stated (R. 22), to be "tantamount to a power to revoke". See *Garland v. Commissioner*, 42 B. T. A. 324, 328, supplemental opinion 43 B. T. A. 731, 735; *Chandler v. Commissioner*, 41 B. T. A. 165, 175-176, affirmed, 119 F. 2d 623, 625-626 (C. C. A. 3d); *Fisher v. Commissioner*, 28 B. T. A. 1164, 1168-1169; *Whiteley v. Commissioner*, 42 B. T. A. 316, 323. See also Treasury Regulations 103, Section 19.166-1, as amended by T. D. 5194, 1942-2 Cum. Bull. 53, and by T. D. 5392, 1944 Cum. Bull. 328, and T. D. 5488, 1946-1 Cum. Bull. 19.

As the Tax Court pointed out (R. 23), the taxpayer in this case retained rights broader than mere "control over the trust investments", and while it might be argued that the words such as "sales" and "purchases" connote transactions

for a fair consideration, no such meaning can be ascribed to the word "loans". In these circumstances, it is clear that the decision below, in so far as it sustains the conclusions of the Tax Court as to the applicability of Section 166, does not conflict, as alleged (Pet. 7), with *Helvering v. Stuart*, *supra*, and *Reinecke v. Northern Trust Co.*, 278 U. S. 339, holding that the retention by the grantor of a power to control trust investments does not amount to a power of revocation.

There is likewise no merit to the claim (Pet. 7) that the court below has decided a question of local law in a way probably in conflict with the applicable local decisions. This contention rests upon the premise (Pet. 7, 10, 12-13) that the grantor of a trust is a fiduciary with respect to powers which he reserves to himself and that he may not exercise such powers for his own benefit, unless specifically authorized to do so by the terms of the trust. In support thereof the taxpayer relies (Pet. 14-15) on *Chandler v. Commissioner*, *supra*, in which the Circuit Court of Appeals for the Third Circuit stated (119 F. 2d 625-626) that a reservation by the grantor of a power to direct the sale or disposition of trust assets is subject to the equitable principles regulating the conduct of fiduciaries, unless the power is expressly reserved for the benefit of the grantor. But this observation in the *Chandler* opinion was drawn from the law of New York (which was applicable to that

case), as enunciated in *Carrier v. Carrier*, 226 N. Y. 114, upon which the taxpayer here also relies. (Pet. 12-13.) However, as is shown by *Osborn v. Bankers Trust Co.*, 168 Misc. (N. Y.) 392, the New York law with respect to powers rests upon a New York statute abrogating the common law, which statute requires that a reserved power of disposition be regarded as a power in trust and not as a beneficial power. The taxpayer has failed to establish that the law of Ohio, which is applicable to this case, is the same as the law of New York, or that there is any Ohio statute abrogating the common law rule with respect to powers, similar to the New York statute referred to in *Osborn v. Bankers Trust Co.*, *supra*.

Nor is there conflict with *Shank v. Dewitt*, 44 Ohio St. 237. That case did not involve a power reserved to himself by the grantor of a trust. There, a testator in his will had given his wife a life estate in his property and authorized her to dispose of his property to his heirs as she thought best, and the court held that the widow, aside from her life estate, had only a power of appointment for the benefit of others, which she could not dispose of to her own benefit contrary to the intention of the testator. See also *Helfferrich v. Helfferrich, Jr.*, 11 Ohio Dec. 234, and 11 Ohio Dec. 303, 311. Clearly, such holdings have no bearing upon the question in this case as to the right of the

grantor of a trust to use his reserved powers for his own benefit.

CONCLUSION

The decision below is correct. It turns upon the particular facts of the case and presents no question calling for further review by this Court. There is no conflict of decisions. The petition should therefore be denied.

Respectfully submitted,

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JANUARY 1947.

APPENDIX

Internal Revenue Code:

SEC. 22. GROSS INCOME.

(a) [As amended by Sections 1 and 3 of Public Salary Tax Act of 1939, c. 59, 53 Stat. 574] *General Definition.*—"Gross income" includes gains, profits, and income derived from salaries, wages, or compensation for personal service (including personal service as an officer or employee of a State, or any political subdivision thereof, or any agency or instrumentality of any one or more of the foregoing) of whatever kind and in whatever form paid, or from professions, vocations, trades, businesses, commerce, or sales, or dealings in property, whether real or personal, growing out of the ownership or use of or interest in such property; also from interest, rent, dividends, securities, or the transaction of any business carried on for gain or profit, or gains or profits and income derived from any source whatever. * * *

(26 U. S. C. 22.)

SEC. 166. REVOCABLE TRUSTS.

Where at any time the power to revest in the grantor title to any part of the corpus of the trust is vested—

(1) in the grantor, either alone or in conjunction with any person not having a substantial adverse interest in the disposition of such part of the corpus or the income therefrom, or

(2) in any person not having a substantial adverse interest in the disposition of such part of the corpus or the income therefrom, then the income of such part of the trust shall be included in computing the net income of the grantor.

(26 U. S. C. 166.)

SEC. 167. INCOME FOR BENEFIT OF GRANTOR.

(a) Where any part of the income of a trust—

(1) is, or in the discretion of the grantor or of any person not having a substantial adverse interest in the disposition of such part of the income may be, held or accumulated for future distribution to the grantor; or

(2) may, in the discretion of the grantor or of any person not having a substantial adverse interest in the disposition of such part of the income be distributed to the grantor; * * *

* * * * *

then such part of the income of the trust shall be included in computing the net income of the grantor.

(b) As used in this section the term "in the discretion of the grantor" means "in the discretion of the grantor, either alone or in conjunction with any person not having a substantial adverse interest in the disposition of the part of the income in question."

(26 U. S. C. 167.)

Revenue Act of 1943, c. 63, 58 Stat. 21:

SEC. 134. TRUSTS FOR MAINTENANCE OR SUPPORT OF CERTAIN BENEFICIARIES.

(a) *Income for Benefit of Grantor*.—Section 167 (relating to income for benefit of

grantor) is amended by adding at the end thereof the following subsection:

"(c) Income of a trust shall not be considered taxable to the grantor under subsection (a) or any other provision of this chapter merely because such income, in the discretion of another person, the trustee, or the grantor acting as trustee or cotrustee, may be applied or distributed for the support or maintenance of a beneficiary whom the grantor is legally obligated to support or maintain, except to the extent that such income is so applied or distributed. In cases where the amounts so applied or distributed are paid out of corpus or out of other than income for the taxable year, such amounts shall be considered paid out of income to the extent of the income of the trust for such taxable year which is not paid, credited, or to be distributed under section 162 and which is not otherwise taxable to the grantor."

(b) *Taxable Years to Which Applicable.*—

(1) *General Rule.*—Except as provided in paragraph (2), the amendments made by subsection (a) shall be applicable with respect to taxable years beginning after December 31, 1942, unless a taxable year of the trust beginning in 1942 ends within a taxable year of the grantor beginning in 1943, in which case, except as provided in paragraph (2), such amendments shall not be applicable to such taxable years of the grantor.

(2) *Retroactive Effect.*—The amendments made by subsection (a) shall also be applicable with respect to all taxable years to which such amendments are not made applicable under paragraph (1), in the same manner

as if such amendments had been a part of the revenue laws applicable to such taxable years, but only if there are filed with the Commissioner (in accordance with regulations prescribed by him with the approval of the Secretary) at such time and by such persons as may be prescribed under such regulations, signed consents that there shall be paid, at such time as the Commissioner may prescribe, all of the taxes under Chapter 1 of the Internal Revenue Code or under the corresponding provisions of prior revenue laws which would have been paid for the taxable years concerned if such amendments had been a part of the revenue laws applicable to such taxable years.

(26 U. S. C., Supp. V, 167.)